(34,071)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1928

No. 762

CARL H. KOTHE, TRUSTEE, PETITIONER,

vs.

R. C. TAYLOR TRUST

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

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[fol. 1] [Caption omitted]

IN UNITED STATES DISTRICT COURT, DISTRICT OF MASSACHUSETTS

No. 39889. In Bankruptcy

In the Matter of HERBERT TURKEL, Bankrupt; In re Appeal of R. C. TAYLOR TRUST

PROOF OF UNSECURED DEBT—Filed with Referee April 3, 1928

At Worcester, in said District of Massachusetts, on the — day of March A. D. 1928 came Frank F. Butler, of Worcester in the County of Worcester and State of Massachusetts, attorney (or authorized agent) of the R. C. Taylor Trust of Worcester in the County of Worcester and State of Massachusetts and made oath and says that Herbert I. Turkel, the person by (or against) whom a petition for adjudication of bankruptcy has been filed, was at and before the filing of said petition, and still is, justly and truly indebted to the said R. C. Taylor Trust in the sum of five [fol. 2] thousand and 00/100 (50,000) dollars; that the consideration of said debt is as follows: damages for breach of lease in the amount of $5,000, that being the same as the amount of rent reserved in the lease from February 15, 1928 to May 15, 1929, the end of the term. The lease under which the bankrupt occupied provided that "the filing of any petition in bankruptcy * * * by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof."

That no part of said debt has been paid; and that this deponent has not, nor has any person by his order, or to this deponent's knowledge or belief, for his use had or received any manner of security for said debt whatever. And this deponent further says, that he is duly authorized by his

principal to make this affidavit, and that it is within his knowledge that the aforesaid debt was incurred as and for the consideration above stated, and that such debt, to the best of his knowledge and belief, still remains unpaid and unsatisfied.

R. C. Taylor Trust, by Frank F. Butler, Trustee.

Subscribed and sworn to before me this thirtieth day of March A. D. 1928. George S. Taft, Justice of the Peace.

May 26, 1928. Disallowed after hearing.
Daniel W. Lincoln, Referee.

IN UNITED STATES DISTRICT COURT

PETITION TO REFEREE FOR REVIEW

To Daniel W. Lincoln, Esq., Referee in Bankruptcy:

Your petitioner respectfully shows:

That your petitioner claims that the bankrupt was at the filing of his petition in bankruptcy, and still is, indebted to it in the sum of five thousand ($5,000);

[fol. 3] That your petitioner duly filed a proof of debt for said amount, the nature of the claim and the consideration of said debt being set forth in said proof of claim;

That upon May 26, 1928 the following order was made on said proof of claim: "May 26, 1928. Disallowed after hearing. Daniel W. Lincoln, Referee";

That such order was and is erroneous as matter of law, there being no question but that the facts were as set forth in said proof of debt.

Wherefore your petitioner, feeling aggrieved because of such order, prays that the same may be reviewed, as provided in the bankruptcy law of 1898 and General Order XXVII.

Dated at Worcester, Mass., May 29, 1928.

R. C. Taylor Trust, by Frank F. Butler, Trustee, Petitioner.

Duly sworn to by Frank F. Butler. Jurat omitted in printing.

IN UNITED STATES DISTRICT COURT

REFEREE'S CERTIFICATE ON REVIEW—Filed June 14, 1928

I, Daniel W. Lincoln, referee in bankruptcy in charge of this proceeding, do hereby certify:

In the course of such proceeding there was filed on April 3, 1928 by the R. C. Taylor Trust a proof of debt for five thousand dollars ($5,000), that the consideration of said debt is as follows:

[fol. 4] "damages for breach of lease in the amount of $5,000, that being the same as the amount of rent reserved in the lease from February 15, 1928 to May 15, 1929, the end of the term. The lease under which he bankrupt occupied provided that 'the filing of any petition in bankrutcy * * * by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof.' "

That on the twenty sixth day of May 1928 I dissallowed said claim after hearing, for the reason that the proof is based on damages for the amount of rent running from the date of the filing of the petition to the end of the term of the lease, no part of such claim being for any rent which had accrued at the time of the filing of said bankruptcy petition.

That on the twenty-ninth day of May 1928 the petitioner, the R. C. Taylor Trust, feeling aggrieved at my order, filed a petition for review.

That the error complained of by the petitioner was that the order was erroneous as a matter of law, there being no question but that the facts were as set forth in said proof of debt.

I attach to this certificate the petition for review.

And said question is certified to the judge for his opinion thereof.

Dated at Worcester, the eighth day of June, A. D. 1928.

Daniel W. Lincoln, Referee in Bankruptcy.

In United States District Court

Decree—June 26, 1928

At Boston, in said District, on the twenty-sixth day of June, A. D. 1928, upon the question certified to the court by the referee in said matter on the fourteenth day of June, [fol. 5] A. D. 1928, now, therefore, after hearing arguments of George S. Taft, Esq., counsel for the R. C. Taylor Trust, and of Frank H. Pardee, Esq., counsel for the Trustee in Bankruptcy, and after due consideration of the same;

It is hereby ordered and decreed that the order of the referee dissallowing the claim of the R. C. Taylor Trust be and it hereby is affirmed.

It is further ordered that the clerk send a copy of this ordered by mail to the referee.

Witness the Honorable James A. Lowell, Judge of said court, and the seal thereof, this twenty-sixth day of June, A. D. 1928.

Mary E. Prendergast, Deputy Clerk. (Seal.)

In United States District Court

Memorandum—June 26, 1928

Lowell, J.:

Petition for a review of the disallowance by Mr. Referee Lincoln of a claim in the sum of five thousand dollars for rent under a lease which contained the following clause:

"The filing of any petition in bankruptcy * * * shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and without entry or other action by the lessor, this lease shall become and be terminated and, * * * the lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof."

This case differs from the unreported case of in the matter of Farley v. McNeill, in which an unreported opinion was filed by me on July 15, 1925. In that case the clause in the lease required the damages sustained by the landlord to be determined in a manner therein prescribed, namely: "an

amount equal to the amount of the rent reserved in this lease for the residue of the term hereof less the fair rental value of the premises for the residue of the term."

[fol. 6] In the present case if the claim is allowed the landlord may prove for the entire amount and then re-let the premises, perhaps at a higher rent.

Petition dismissed.

IN UNITED STATES DISTRICT COURT

PETITION FOR APPEAL BY R. C. TAYLOR TRUST AND ORDER ALLOWING SAME—Filed July 17, 1928

To the Honorable James A. Lowell, District Judge of the United States District Court for the District of Massachusetts:

The petitioner, the R. C. Taylor Trust, conceiving itself aggrieved by the final order and decree entered on the twenty-sixth day of June 1928, in the above-entitled proceeding, dismissing the petition, does hereby petition for an appeal from said order and decree to the United States Circuit Court of Appeals for the First Circuit, and prays that his appeal may be allowed and a citation granted, directed to Carl H. Kothe, the trustee, commanding him to appear before the United States Circuit Court of Appeals for the First Circuit, to do and receive what may appertain to justice to be done in the premises, and that a transcript of the record, proceedings and evidence in said proceeding, duly authenticated, may be transmitted to the United States Circuit Court of Appeals for the First Circuit.

R. C. Taylor Trust Petitioner. George S. Taft, Solicitor for Petitioner.

The foregoing appeal is hereby allowed. James A. Lowell, D. J.

IN UNITED STATES DISTRICT COURT

ASSIGNMENT OF ERRORS—Filed July 17, 1928

Now comes the R. C. Taylor Trust, petitioner, and files the following assignment of errors on appeal from order of this court dated June 26, 1928:

First. That the United States District Court for the District of Massachusetts erred in dismissing the petition.

[fol. 7] Second. That the order of the referee disallowing the petitioner's claim was erroneous as a matter of law, there being no question but that the facts were as set forth in the proof of claim; that consequently the United States District Court erred in not allowing the petition for review.

R. C. Taylor Trust, by George S. Taft, Solicitor for Bankrupt.

In United States District Court

Waiver of Bond on Appeal—Filed July 17, 1928

Now comes Carl H. Kothe, trustee of the above-entitled bankrupt, and waives his right to a bond on appeal by the R. C. Taylor Trust from order dismissing its petition for review.

Carl H. Kothe, Trustee.

In United States District Court

Præcipe for Transcript of Record—Filed July 19, 1928

To the Clerk of the United States District Court for the District of Massachusetts:

You are hereby requested to make a transcript of record to be filed in the United States Circuit Court of Appeals for the First Circuit pursuant to an appeal allowed in the above-entitled proceeding, and to include in such transcript the following:

1. Proof of unsecured debt.
2. Petition to referee for review.
3. Referee's certificate.
4. Opinion of court.
5. Decree or order.
6. Petition for appeal.
7. Assignment of errors.

8. Citation on appeal.
9. Waiver of bond.
10. Præcipe.

George S. Taft, Solicitor for Petitioner.

[fol. 8] Service of above præcipe admitted this nineteenth day of July, 1928, and assent.

Frank H. Pardee, Solicitor for Trustee.

Citation, in usual form, showing service on Carl H. Kothe, omitted in printing.

[fols. 9 & 10] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 11] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT, OCTOBER TERM, 1928

No. 2273

R. C. TAYLOR TRUST, Creditor, Appellant,

v.

CARL H. KOTHE, Trustee, Appellee

Appeal from District Court of the United States for the District of Massachusetts

Before Bingham, Johnson, and Anderson JJ.

OPINION—January 8, 1929

JOHNSON, Circuit Judge:

This is an appeal from an order of the District Court of the United States for Massachusetts.

The R. C. Taylor Trust leased, April 20, 1927, to Herbert I. Turkel certain real estate for a term of two years, to being May 15, 1927. The rent reserved was $4,000 per year

payable in equal monthly payments in advance. The lease contained the following provision:

"The filing of any petition in bankruptcy * * * by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof."

[fol. 12] Turkel afterwards was adjudged a bankrupt, but just when the petition was filed upon which adjudication was made does not appear in the record.

The lessor later filed a proof of claim for damages amounting to $5,000, which was the rent reserved in the lease for the residue of the term thereof—1¼ years.

The referee disallowed the claim and upon petition for review the District Court sustained the referee and dismissed the petition.

It is well settled law in this circuit that a claim for rent accruing after the filing of a petition in bankruptcy is not a provable claim. The quoted provision in the lease was clearly inserted for the purpose of enabling the lessor in the event of bankruptcy to protect itself to some extent against the loss of rent for the term of the lease remaining after the filing of a petition in bankruptcy. Under it the filing of a petition in bankruptcy, either by or against the lessee, was made to constitute a breach of the lease which at once was terminated. No rent could accrue after its termination. For the breach of the lease the lessor was entitled to damages. These damages are fixed as the amount of the rent reserved under the lease. The claim presented by the lessor is therefore not for rent but for damages to which he is entitled under this provision of the lease. The rent reserved for the balance of the term was employed by the parties to measure the damages to which the lessor was entitled. They were not dependent upon contingencies which render rent to accrue not a provable claim because not absolutely due at the time of the filing of the petition in bankruptcy. They were made absolutely payable simultane-

ously with the filing of the petition in bankruptcy. See Statement of Lowell, Circuit Judge, in In re Pettingill, 137 Fed. 143, 146, where it is said: "For admission to proof, however, the claim need not arise before bankruptcy, nor need the contract be broken theretofore. It is sufficient for proof if the breach of contract and bankruptcy are coincident."

Judge Putnam, in In re Swift, 112 Fed. 315, 321, in discussing whether a claim that did not arise until the filing of a petition in bankruptcy was a provable claim, uses this lan-
[fol. 13] guage: "The contract ripened simultaneously with the beginning of the proceedings in bankruptcy, as the consequence thereof in connection with the adjudication which followed. Of course, as everything related back to the filing of the petition, the ripening of the claim did not occur before it was filed, nor afterwards, but simultaneously with it, as already said." See also Central Trust Company v. Chicago Auditorium Association, 240 U. S. 581, where the Supreme Court quotes with approval the language of Judge Lowell in In re Pettingill, supra; and also In re Mullings Clothing Company, 238 Fed. 58, 67.

It will be noted that the provision in question makes the lease to terminate and does not provide that it shall be forfeited upon the filing of a petition in bankruptcy. If forfeited it might call for some action upon the part of the lessor, but it is here provided that without any entry or action by the lessor "the lease shall become and be terminated." It cannot be said that the amount of damages to be recovered is so largely in excess of any actual damage that the lessor may suffer that it must have been intended as a penalty and its recovery would be unconscionable.

The term of the lease was short—two years. While there is nothing in the record to disclose that it was necessary for the lessor to expend considerable money in the preparation of the property for the use to which the lessee might wish it devoted, it is not an unreasonable inference that it did so. It is true that if the claim is allowed it will diminish the dividends to be paid to other creditors, but we are not concerned with this result. The only question presented upon this record is whether or not the claim made by the lessor is a provable one under Section 63 (a) 4 of the Bankruptcy Act of 1898.

It is contended by the trustee that the provision above cited was intended to operate as a penalty and not to fix the amount to be paid as liquidated damages. Whether an agreement to pay a fixed sum of money for a default in the performance of a contract is a penalty or liquidated damages depends upon the intention of the parties. Morrill v. Weeks, 70 N. H. 178, 180, and cases there cited; Sun Printing & Publishing Association v. Moore, 183 U. S. 642, 669; [fol. 14] United States v. Bethlehem Steel Co., 205 U. S. 105, 119; Guerin v. Stacy, 175 Mass. 595, 597; Lynde et al. v. Thompson, 2 Allen 456.

A well known exception to this test is where the promise or agreement is to pay a large sum of money in the event of a default in the payment of a much smaller sum, in which case the law makes interest the measure of damages for failure to pay money when it is due, and will not permit parties to avoid the usury laws in this way. Mead v. Wheeler, 13 N. H. 351; Morrill v. Weeks, supra. In other words such a contract, because of the usury laws, is construed as for a penalty or security beyond which damages cannot be recovered.

In the case now before us the contract or promise is not to pay a larger sum of money for a much smaller fixed sum, nor a sum as damages larger than is apparent from all the circumstances would cover actual damage; and its language plainly indicates that the parties intended that the sum agreed to be paid, in case of a breach, should be liquidated damages and not a penalty.

There is no evidence from which it could be found that the actual damages sustained by the claimant (the lessor) were less than those agreed upon, and that those agreed upon were increased or made greater by padding those that would probably be sustained.

As the agreement is one for liquidated damages, can it be said to be invalid as being a fraud on the creditors of the bankrupt (the lessee), or a preferential transfer or conveyance?

There is no evidence that the bankrupt intended to defraud his creditors or that the claimant knew of such intention, if it existed. It is, therefore, not void on that account.

It does not appear that the bankrupt was insolvent when the lease was made; and the covenant in regard to damages, if it could be said to effect a preferential transfer, was plainly not made within four months of the filing of the petition in bankruptcy.

The analogies suggested in the brief of the creditor arising in cases of leases of personal property where by their [fol. 15] terms the whole amount becomes due in case of default are not applicable to real property where by the terms of the lease the parties have fixed with certainty the damages to be recovered upon its breach or, what amounts to the same thing, determined the method of their certain ascertainment.

The decree of the District Court is reversed and the case is returned to that court for further action not inconsistent with this opinion, the appellant to recover costs to be paid from the assets of the bankrupt.

IN UNITED STATES CIRCUIT COURT OF APPEALS

DISSENTING OPINION

ANDERSON, J. (dissenting):

This is an important case. The doctrine now laid down by the majority opinion opens a wide door for schemes to nullify the Bankruptcy Act.

The real case is not stated in that opinion with entire accuracy and clarity. The record is short. The only evidence is the sworn proof of claim that the bankrupt is "justly and truly indebted * * * in the sum of five thousand and 00/100 (5,000) dollars * * * damages for breach of lease in the amount of $5,000, that being the same as the amount of rent reserved in the lease from February 15, 1928 to May 15, 1929, the end of the term. The lease under which the bankrupt occupied provided that 'the filing of any petition in bankruptcy * * * by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this

lease the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof.' "

The referee simply certified "that the facts were as set forth in said proof of debt." Neither the date nor the term of the lease is stated. For those my brethren resort to the briefs. There was no claim or ground for claim that the provision for damages equivalent to rent could be sustained as liquidated damages because "the term of the lease was [fol. 16] short," and the lessor might have expended "considerable money" in adapting the leased property to the bankrupt's use. There is neither evidence nor presumption that the lessor made any such expenditure. The case presented and argued is that such provision for transmuting non-accrued rent into damages makes a claim provable against the lessee's bankrupt estate; whatever the term, whenever bankruptcy comes, and without regard to actual damage suffered. Appellant's learned counsel frankly and correctly cenceded at the argument that, if this claim is provable, a like claim under a lease for forty years, terminated by the lessee's bankruptcy at the end of one year, would be provable. And for present purposes a lease is no different from many other kinds of contracts. The ruling now made would support a claim arising under a long term contract to furnish goods, deliveries and payments to be made periodically in installments,—by inserting a stipulation that the bankruptcy of the purchaser should, ipso facto, be held a breach remitting the seller to damages equal to the price of the undelivered goods. The seller would keep his undelivered goods and have a provable claim equal to the selling price thereof. So also in a contract for personal services, running for years,—the bankruptcy at any time of the employer may be made to remit the employee to a provable claim for damages equal to the remainder of his compensation for the whole period.

In this actual case and in both of the hypothetical cases, it is quite possible that the bankruptcy of the lessee, purchaser or employer work no damage whatever to the other party. Here, for aught we know, the lessor may have immediately relet at an increased rent, after getting rent in advance for a month during which he had the premises. In

the hypothetical case of the sale of goods, the seller may have resold at a higher price the goods contracted to the bankrupt. In the hypothetical case of personal services, the employee may have profited from the termination of his contract and the resultant opportunity for more lucrative employment. If, in the absence of all evidence, there is any presumption that the breach of such contracts works any damage at all, there is certainly neither presumption nor [fol. 17] probability that such damage equals the balance accruing under the contracts thus terminated, so that the suppositious victim of a breach is released from his recurrent obligations thereunder. In other words, such stipulations ground claims for damages purely artificial and having no sensible or approximate relation to the realities of the varying situations; in dominant aspects they provide for penalties assessable, not upon the party in default, but upon his creditors.

Illustrations might be multiplied indefinitely. Compare Van Iderstein v. National Bank, 227 U. S. 575, 582; 4 Remington (3d Ed.) section 1527.

In my view, such contracts are, on their face and in essential nature, in fraud of future creditors of the prospective bankrupt. They are agreements by prospective bankrupts to give the other parties to these contracts dividends belonging, in whole or in large part, to the bankrupts' real creditors; they import intent to defraud. They contemplate padding claims in order to prevent other creditors from having the benefit of the equality provisions of the Bankruptcy Act. In effect, they provide for proving false claims; for prospective bankrupt and creditor to agree that the creditor's claim shall be magnified in order to give him assets belonging beneficially to other creditors has exactly the same effect on the rights of those other creditors as creating a claim ab initio from nothing. Analyzed, both are attempts to get other people's money by false representations.

In another aspect this provision was for a penalty,—not for liquidated damages. The intent of the parties is only one test in the ordinary case involving only the rights of the parties to the agreement,—frequently disregarded if the result thus reached be illegal or unconscionable. 17 C. J. p. 936, and cases cited. But when, as here, the intent is,—not to pay from the property of the party breaking the

contract, but from property of others, the intent condemns the contract; it does not validate it. The cases cited in the majority opinion rest on the principle that parties sui juris may contract to do as they like with their own. In this case the parties undertook to contract or damages payable [fol. 18] from an estate belonging beneficially in no part to the breaker of the contract; on adjudication the entire estate vested beneficially in the creditors.

In another aspect, this is nothing but an agreement for proving non-accruing rent by simply calling it damages; it assumes that the courts may be beguiled by an alias into disregarding realities. I can find no authority whatever for upholding such an obvious scheme of fraud upon the Bankruptcy Act.

[fol. 19] In United States Circuit Court of Appeals

Clerk's Certificate

On January 8, 1929, this cause came on to be heard, and was fully heard by the court, Honorable George H. Bingham, Honorable Charles F. Johnson and Honorable George W. Anderson, Circuit Judges, sitting.

Thereafter, to wit, on February 18, 1929, the opinion of the court (page 11) and a dissenting opinion (page 15) were filed, and the following Final Decree was, entered:

Final Decree—February 18, 1929

This cause came on to be heard January 8, 1929, upon the transcript of record of the District Court of the United States for the District of Massachusetts, and was argued by counsel.

Upon consideration whereof, It is now, to wit, February 18, 1929, here ordered, adjudged and decreed as follows: The decree of the District Court is reversed, and the case is returned to that court for further action not inconsistent with the opinion passed down this day, the appellant to recover costs to be paid from the assets of the bankrupt.

By the Court.

Arthur I. Charron, Clerk.

IN UNITED STATES CIRCUIT COURT OF APPEALS

ORDER STAYING MANDATE

Thereafter, to wit, on February 18, 1929, upon motion of appellee, mandate was stayed until further order of court.

Clerk's certificate to foregoing transcript omitted in printing.

[fol. 20] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed April 15, 1929

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the First Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on cover: File No. 34,071. United States Circuit Court of Appeals, First Circuit. Term No. 762. Carl H. Kothe, trustee, petitioner, vs. R. C. Taylor Trust. Petition for writ of certiorari and exhibit thereto. Filed March 11th, 1929. File No. 34,071.